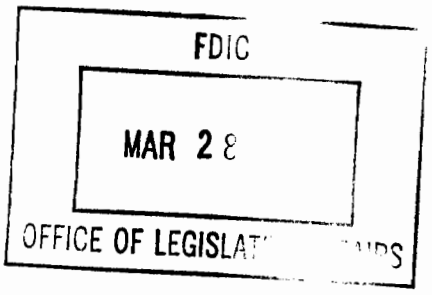
LA06-157 002

JAMES A. LEACH
SECOND DISTRICT, IOWA

COMMITTEES:
FINANCIAL SERVICES
CHAIRMAN EMERITUS

INTERNATIONAL RELATIONS
SUBCOMMITTEE:
ASIA AND THE PACIFIC
CHAIRMAN

CONGRESS OF THE UNITED STATES
March 27, 2006



Martin Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW
Washington, D.C. 20429

Dear Chairman Gruenberg:

As the former chairman of the House Banking Committee and of the House-Senate conference on the Gramm-Leach-Bliley Act (GLB), I have generally taken the position not to give regulators post-legislation interpretive advice. However, in this instance, some legislative history of this particular measure as well as the historical context of banking legislation may be useful to the FDIC as you decide whether to authorize the world's largest retailer the right to open a bank-like institution.

In the development of GLB, some parties advocated mixing banking and commerce. Congress carefully considered this issue and chose not to endorse such an approach, thereby sticking with clear legislative precedent.

Congress has explicitly forbidden banks from engaging in commercial endeavors. Implicitly, it is irrational to think that a commercial company, by buying or establishing a banking institution such as an Industrial Loan Company (ILC), should be able to do what Congress prohibited in reverse. What was prohibited in one direction should not be sanctioned in another.

There were four broad intents in the GLB financial modernization legislation: (1) to enhance three-way competition between the banking, securities and insurance industries; (2) to create functional regulation by category of activity; (3) to establish a principal umbrella regulator to ensure that regulatory cracks are filled; and (4) to curtail regulatory arbitrage at the federal level.

This fourth point is seminal to the discussion at hand. In developing compromises to make GLB possible I fully understood that private sector industries had rival interests and that maximization of profit was a respectable motivation in a free market economy. But I was continually surprised at the intensity of bureaucratic rivalries and had minimal respect for the maximization of power motivation of public sector institutions. It is in this context that I am concerned that a regulatory power rivalry may resurface in the ILC issue. As the primary federal regulator of ILCs, the FDIC has the potential to empower commercial companies and, in so doing, aggrandize its own

OFFICES:
2186 RAYBURN HOUSE OFFICE BLDG.
WASHINGTON, DC 20515-1501
(202) 225-6576
FAX: (202) 226-1278

214 JEFFERSON STREET
BURLINGTON, IA 52601-5215
(319) 754-1106
FAX: (319) 754-1107

129 12TH STREET, SE
CEDAR RAPIDS, IA 52403-4074
(319) 363-4773
FAX: (319) 363-5008

125 SOUTH DUBUQUE STREET
IOWA CITY, IA 52240-4003
(319) 351-0789
FAX: (319) 351-5789

105 EAST 3RD STREET
ROOM 201
OTTUMWA, IA 52501-2804
(641) 684-4024
FAX: (641) 684-1843

regulatory jurisdiction. But Congress' goal in GLB was to protect the public interest by establishing cooperative rather than confrontational relationships between regulators. Although the FDIC is critically important in the federal regulatory regime, it is not intended to be an exclusive authority. The Congress concluded in GLB that consensus institutional decision-making was vastly preferable to regulatory arbitrage.

In an extensive review I requested last year, the Government Accountability Office, a neutral observer, pointed out that when the Federal Reserve is deprived of a regulatory role, significant gaps in oversight can occur. The FDIC has limited experience in holding company oversight and, more importantly, lacks the legal right to review the financial well-being of holding companies.

Under a Bank Holding Company Act (BHCA) framework from which ILCs are currently shielded, the Federal Reserve is empowered to establish consolidated capital requirements to ensure that holding companies are a source of financial strength for a subsidiary bank. Under the BHCA, commerce and banking cannot be merged. Where financial companies have holding companies, the Federal Reserve has broad enforcement authority. It can issue cease and desist orders, impose civil penalties and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness, or stability of an affiliated bank or is inconsistent with sound banking principles. Corporate parents of ILCs are not subject to these requirements.

In our market economy, seldom is short-term viability a guarantor of long-term financial strength. Without the safeguard controls that exist under the BHCA, it is problematic for the government to prevent deficiencies and damage to the federal safety net.

More profoundly, it is troubling to envision the consolidation of ownership and other changes in the nature of our economy which will occur if banking and commerce are integrated. There is, after all, a catch-22 dilemma in allowing commercial companies to own federally insured financial institutions such as ILCs. Commercial companies which are weak or become weak could easily develop conflicts that jeopardize the viability of a federally insured institution. On the other hand, those which are strong could too easily precipitate chain-reaction consolidations of ownership or tilt the competitive marketplace in anti-competitive ways.

Finally, a note about the bizarre circumstance that ILCs are limited by law to only a handful of states. The effect of this legal situation is that the specially empowered states have a vested interest in approving ILC charters, which may be awarded to foreign as well as domestic entities, despite the fact that certain charters might fly in the face of federal precedent and good governance practices. The concentration of ILCs in a few states has the effect of taking jobs

from the majority of states and, more profoundly, might alter the nature of the American economy based on judgment calls of regulators whose principal concern may be the state, rather than the national, interest.

There is simply no reason to jeopardize the independence and viability of the American financial system with risky bets on the continuous commercial strength of ILC parent companies, dubious assurances of regulatory adequacy and dreams of self-aggrandizing conglomeration.

Thank you for your consideration.

Sincerely,

James A. Leach
Member of Congress

JL:mb

cc: John F. Carter